88-2045

NO.

Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
CLERK

In the
Supreme Court of the United States

OCTOBER TERM, 1988

EMPLOYERS INSURANCE OF WAUSAU, AS REPRESENTATIVE OF THOSE CERTAIN AMERICAN UNDERWRITERS SUBSCRIBING TO CERTIFICATE NO. 14880

Petitioner

VERSUS

AVONDALE SHIPYARDS, INC., OGDEN CORPORATION, SEABULK TRANSMARINE II, INC., HVIDE MARINE INTERNATIONAL, INC., AND HVIDE SHIPPING INCORPORATED

Respondents

ON WRIT OF CERTIORARI FROM THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI

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A B Letter Service, Inc., 327 Chartres St., New Orleans, La. (504) 581-5555

QUESTIONS PRESENTED FOR REVIEW

A. Whether the Guarantee Deficiency Clause of a vessel construction contract subsumes an express warranty of seaworthiness.

B. If the Guarantee Deficiency Clause does subsume the express warranty of seaworthiness set forth in the Construction Contract, whether that provision limits contractual remedies to the cost of repair or replacement of defective material or workmanship when the vessel sinks as a result of such a defect and is not recovered.

C. Whether the economic loss rule of *East River Steamship Corporation v. Transamerica Delaval, Inc.*, 476 U.S. 858, 106 S.Ct. 2295, 90 L.Ed. 2d 865 (1986) ("*East River*") bars an action in maritime tort for the negligence of a party, other than the shipbuilder, who had contracted to provide professional services in connection with the construction of a vessel.

D. Whether the defense afforded by *East River* can be asserted for the first time on appeal when the issue of any failure of the Complaint to state a claim upon which relief could be granted was not raised prior to the conclusion of trial on the merits.

LIST OF PARTIES

Pursuant to Rule 21.1(b) of the Supreme Court of the United States the American Underwriters certify that the following parties are interested in the outcome of this proceeding:

Aachener Ruck
Aachener Ruckversicherungs Gesellschaft
Adams & Reese
Ago Schadeverz Mij
Allianz Insurance Co. Ltd.
Allianz International Insurance Co. Ltd.
Alpina Versicherungs Zurich
American Marine Underwriters, Inc.
Americas Insurance Company
Andrew Weir
Andrew Weir Insce Co. Ltd.
Andrew Weir Insco Ltd. SB T A/C.
Ass. Mij de Scoen Provincien Assce
Assicurazione Generali S. p A.
Atlantic Insurance Co.
Atlantic Mutual Insurance Co.
Atlas Assurance Co. Ltd. T A/C.
Avondale Shipyards, Inc.
Avondale Industries, Inc.
Baloise Insce Co., Ltd.
Baltica Scandinavian Insurance Company (UK) Ltd.
Bavarian Re
Bayerische Ruckversicherung A.G.
Brauer & Heye
British Law
British Reserve Ins. Co. Ltd.
Burlingham, Underwood & Lord
Cadwalader, Wickersham & Taft
Chaffe, McCall, Phillips, Tolar & Sarpy
Chiyoda Fire & Marine Insurance Company
Commercial Union Assurance Co. Ltd.
Compagnie D'Assce M'imes Aeriennes et Terrestres
Cornhill Insurance Co. Ltd. SV7
Cornhill Insurance Company
Danish Marine Insurance Company Ltd.
Donald H. Miller, Inc.
Drake Insurance Co. Ltd.
Employers Insurance of Wausau
English & American Ins. Co. Ltd. M 2 A/C
English & American Ins. Co. M1 A/C
English & American Insurance Co. Ltd. T A/C

Ennia Schadeverz
Excess Insce
Federal Insurance Co. of New Jersey, New York
Forsakrings-Akticbolaget 'Securitas', Lund
Frankona Ruck
Frankona Ruckversicherungs Aktiengesellschaft
Fred S. James & Co. of New York, Inc.
Gelpi, Sullivan, Carroll & LaBorde
General Electric Credit Corp. of Georgia
Gerling Global
Gerling Globale Ruckversicherung Aktiengesellschaft
Gothaer Trans
Gothaer Transport Und Ruckversicherung Aktiengesellschaft
Hannover Int. Insurance (NED) N.V.
Hansa Marine Insurance Co. (UK) Ltd.
Hansa Marine Insurance Company (UK) Ltd. S. GP.
Hartford National Bank and Trust Co.
Hill, Betts & Nash
Hudig-Langeveldt
Hvide Marine International, Inc.
Hvide Shipping, Incorporated
Iduna Allgeme
Iduna Allgemeine Versicherung A. G.
Inland Underwriters Insurance Company
Insce Corporation of Ireland Ltd. L A/C.
Insce Corporation Ltd. L A/C
Insurance Corporation of Ireland Ltd.
Insurance Corporation of Ireland Ltd. L A/C.
Iron Trades Ltd.
Iron Trades Mutual Insurance Co. Ltd.
Jauchn Hubener
J. J. Henry Co., Inc.
Jones, Walker, Waechter, Poitevent, Carrere & Denegre
KOA
Kolnische Ruckversicherungs Gesellschaft
La Preservatrice C. A. D' Assce - Aird E
La Reunion Francaise Soc Anon D'Assces et Des Reass PL A/C.
Liskow & Lewis
Lloyd's Syndicate Nos. 868, 505 127, 700, 764, 908,145, 209, 288, 653, 728, 448, 449, 447, 206, 725
London & Hull Maritime Insurance Co. Ltd.
Lugenbuhl, Burke, Wheaton, Peck & Rankin
Malvern Insurance Co. Ltd.
Malvern Insurance Ltd.
Malverns Insurance
Minster Insce Co. Ltd.
Minster Insce Co. Ltd. 1 A/C.
M.U. Cambridge Ins. Co. (UK) Ltd.
National Nederlanden Schadeverz
Nordstern
Nordstern Allgemeine Versicherungs Aktiengesellschaft
Northern Assce T A/C
Norwich Union CTY Ltd. Trust A/C

Norwich Union Fire Ins. Socty Ltd. Trust A/C.
Norwitch Union Fire Insce Socty Ltd. Trust Z A/C.
Occidental Chemical Agricultural Products, Inc.
Occidental Chemical Corporation
Occidential Petroleum Corporation
Ocean Marine
Ocean Marine Insurance Co. Ltd.
Ogden Corporation
Onsce Co. of (UK) Ltd.
Orion Insurance Co. Ltd. T A/C
Orion Insurance Co. Ltd. T A/C, the
Phelps, Dunbar, Marks, Claverie & Sims
Polaris Norske Sjo Insurance Company, Ltd.N A/C
Price Forbes
Provincial Insce Co. Ltd.
Prudential Assce Co. Ltd. Trust A/C
Prudential Trust
QBE Insurance Ltd.
Reed & Brown, Inc. (now CRB Management, Inc.)
River Thames Insurance Co. Ltd.
Road Transport Insurance Company Ltd.
Rochdale Insurance Company —
Rotterdamse Assurantiekas
Royal Insce
Royal Insurance Co. Ltd.
Seabulk Tankers, Ltd.
Seaulk Transmarine I, Inc.
Seabulk Transmarine II, Inc.
Seabulk Transmarine III, Inc.
Sedgwick Chartered Hong Kong Ltd.
Sedgwick Marine Ltd.
Seine et Rhone Oceanide Reunies, Paris
Sessions, Fishman, Rosenson, Boisfontaine, Nathan & Winn
Seven Provinces Insurance Co. Ltd.
Shea & Gouid
Societe Commerciale de Reassurance
Southern Marine & Aviation Underwriters, Inc.
Soverign General Insurance Co. Ltd. SXI
Sovereign Marine & General Insurance Co. Ltd.
Sphere Insce Co. Ltd.
Sphere Insurance Co. Ltd.
Sphere Insurance Co. Ltd. B ACC.
Sphere Insurance Company Ltd. B A/C
Standard Chartered Insurance Brokers (Singapore) Ltd.
Stone, Pigman, Walther, Wittmann & Hutchinson

Storebrand Insurance Co. (UK) Ltd.
Storebrand Ltd.
Suwannee River Chartering, Inc.
Suwannee River Lines, Inc.
Suwannee River Phosophate Lines, Inc.
Suwannee River SPA Lines, Inc.
Switzerland General Ins. Co. (London) Ltd.
Taisho M. Insurance Co. (UK) Ltd.
Taisho Marine & Fire Insurance Co. (UK) Ltd.
The Drake Insce Co. Ltd.
The London Assurance
The Netherlands Insurance Co.
The Nippon Fire & Marine Insurance Co. (UK) Ltd.
The Threadneedle Insurance Co. Ltd.
The Tokio Marine & Fire Insurance Co. (UK) Ltd.
The Tokio Reinsurance Co. (UK) Ltd.
The Yasuda Fire & Marine Ins. Co. (UK) Ltd.
Thuringia Ver
Thuringia Versicherungs Aktiengesellschaft
Tollenaar and Welsener
Travelers Insurance Company
Unigard Mutual Insurance Co.
Unione Italiana Reinsurance of America
United Americas Insurance Co.
United States Fidelity and Guaranty Co.
Vesta Bergen
Vesta (UK) Insurance Company Ltd.
VMW Industries, Inc. (formerly Victoria Machine Works, Inc.)
Yasuda Fire & Marine Insurance Co. (UK) Ltd. T A/C

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REPORTS OF OPINIONS DELIVERED BELOW

The opinion of the Appellate Court is reported as *Employers Insurance of Wausau v. Suwannee River SPA Lines, Inc.*, 866 F.2d 752, reh. den., 871 F.2d 121 (5th Cir. 1989). The opinion of the District Court is unreported.

STATEMENT OF JURISDICTION

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1) on the ground that the decision of the Court of Appeals for the Fifth Circuit conflicts with the statutes of the State of New York and with the decisions of its Courts on a matter of state law at issue in this proceeding. In addition, the decision of the Appellate Court addresses an important question of federal law which has not been, but which should be, decided by this Court. Finally, the Court of Appeals has so far departed from the accepted and usual course of judicial proceedings by permitting, over the objection of Petitioner, the assertion of a defense that had been waived in the District Court as to call for an exercise of this Court's power of supervision. As Judgment was rendered and entered by the Court of Appeals on February 13, 1989, and Petitions for Panel Rehearing and for Rehearing En Banc were denied on March 20, 1989, this Petition for Certiorari complies with the requirements of 28 U.S.C. §2101(c).

STATUTORY PROVISIONS INVOLVED

A. New York UCC §2-316(1) (McKinney 1964)
§2-316. Exclusion or Modification of Warranties

> (1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be con-

strued whenever reasonable as consistent with each other; but subject to the provisions of this Article on parol or extrinsic evidence (Section 2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.

B. New York UCC §2-317 (McKinney 1964)

§2-317. Cumulation and Conflict of Warranties Express or Implied

Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

C. New York UCC §2-719 (McKinney 1964)

§2-719. Contractual Modification or Limitation of Remedy

(1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those

provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and

(b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it in the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its esssential purpose, remedy may be had as provided in this Act.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

D. Federal R. Civ. P. 12(h) (2)

Rule 12. Defenses and Objections - When and How Presented - By Pleading or Motion - Motion for Judgment on the Pleadings.

(h) Waiver or preservation of certain defenses.

***

(2) A defense of failure to state a claim upon which relief can be granted, a defense of failure to join a party indispensable under Rule 19, and an objection of failure to state a legal defense to a claim may be made in any pleading permitted or ordered under Rule 7(a), or by Motion for Judg-

ment on the pleadings, or at trial on the merits.

STATEMENT OF THE CASE

During the early 1970's, Occidental Petroleum Corporation ("Occidental") began to manufacture superphosphoric acid for export to the Soviet Union. As part of this business venture, Occidental required special vessels to transport this substance across the Atlantic Ocean to Russian ports in the Black Sea. Among various options, Occidental chose to construct three identical catug ITBs. The OXY PRODUCER and the Barge OXY 4102 were the second of this series of vessels.

A catug ITB is composed of a tug and a barge unit "mated" through an interconnection system and designed to behave as if it were one vessel. The tug has two catamaran hulls connected by a crossover structure. A ledge protrudes from the lower portion of each catamaran hull. The after end of the barge is tapered to fit into the "wedge" formed by the hulls of the tug on each side, the tug crossover, and the ledges protruding from the hulls. Strips of greenheart wood, a hardwood with frequent maritime applications, are placed along the upper surfaces of the after end of the barge and the ledges protruding from the catamaran hulls. The contact of these greenheart surfaces with the steel underside of the tug crossover and with the steel hull of the barge, respectively, generates friction which, together with other portions of the interconnection system, keep the tug and the barge mated during a voyage.

The interconnection system has additional features. First, there are four bumper pads located between the tug and barge hulls. These consist of rubber mats preloaded to 800 tons of compression sandwiched between steel base plates. Two of these pads were welded to the after end of the barge, one on each side. The other two pads were welded to the forward inside surfaces of the catamaran hulls.

These pads were designed to prevent any transverse, or side-to-side, movement of the vessel after mating and during operation at sea. Second, two link arms connect the crossover of the tug with the deck of the barge. The link arms were designed to pull the tug and the barge together in order to supplement the fit.

Several parties were involved in the construction of the tug, the barge, and the interconnection system. As owner of the catug design, and having operated other catug ITB's, Seabulk Transmarine II, Inc., Hvide Marine International, Inc. and Hvide Shipping, Inc. (hereinafter collectively referred to as "Hvide") contracted to supervise the design and construction of the tug, barge, and interconnection units and warranted that the vessels, when mated, would be seaworthy.

J. J. Henry Co., Inc. ("J. J. Henry") contracted with Occidental to prepare the plans and specifications for each vessel, and to review the Contractor's working drawings. J. J. Henry expressly warranted that if its plans were followed, the vessels, when mated, would be seaworthy.

The actual construction of both the OXY PRODUCER and the Barge OXY 4102 was performed by Avondale Shipyards in New Orleans, Louisiana. Avondale entered into a contract with Occidental for the construction of these vessels. In the construction contract, Avondale expressly warranted that the OXY PRODUCER and the Barge OXY 4102 would be constructed in accordance with the plans and specifications, and that the vessels would be seaworthy. Avondale's performance was guaranteed by Ogden Corporation.

The final participant in the construction of the vessels, insofar as this litigation is concerned, was Victoria Machine Works, Inc. ("Victoria Machine"). It contracted

with Avondale to design and manufacture the bumper pads used to prevent transverse motion between the vessels after mating.

The OXY PRODUCER and her barge, the OXY 4102, made one successful round-trip to the Soviet Union. However, on the second voyage, rough weather was encountered during which the system connecting the vessels deteriorated. The relative movement between the tug and the barge, generated after the deterioration of the interconnection system, opened holes in the catamaran hulls and ultimately resulted in the sinking and total loss of the OXY PRODUCER, the tug unit of the ITB, on Septermber 20, 1981. Although the barge was salvaged, it was designed to be used *only* with the OXY PRODUCER, and was rendered essentially worthless by the casualty. Accordingly, it was deemed to be a total loss.

As found by both the Trial Court and the Court of Appeals, the deterioration of the interconnection system was caused by the improper mating of the units of ITB. The tug, its barge, and the interconnection system, if designed and constructed properly, should have been able to weather the conditions encountered easily. However, the OXY PRODUCER was delivered with virtually no greenheart contact between the tug and the barge. Rather than the 85 to 90% greenheart contact required by the specifications, the tug rested on only a few high spots of the barge greenheart surfaces, achieving contact of just ten percent. Contact at the specified range was necessary to avoid rapid greenheart wear and a sudden decompression of the linkage system.

As a result of the loss, Occidental and its insurers commenced this action in the United States District Court

for the Eastern District of Louisiana against J. J. Henry, Avondale, Ogden, and Hvide alleging claims sounding in maritime tort and contract. The plaintiffs claimed that each defendant breached its respective contractual obligations and that each defendant negligently performed those obligations. Plaintiffs also filed suit, in tort, against Victoria Machine, alleging that it negligently designed the bumper pads placed on the vessels. Jurisdiction in the District Court was based on Admiralty and Maritime Jurisdiction, 28 U.S.C. §1333, with jurisdiction over the state-law contractual claims grounded in the Court's pendant and ancillary jurisdiction.

After the conclusion of the liability portion of a bifurcated trial, the Trial Court rendered judgment dismissing all claims against defendants Victoria Machine and J.J. Henry, holding the remaining defendants, Avondale, Ogden Corporation (hereinafter collectively referred to as "Avondale"), and Hvide, liable for the loss of the OXY PRODUCER. The plaintiffs denominated as Occidental and the "British Underwriters" appealed the dismissal of Victoria Machine Works and J. J. Henry to the United States Court of Appeals for the Fifth Circuit pursuant to 28 U.S.C. 1292(a)(3).[1] Defendants Avondale and Hvide also filed an interlocutory appeal of the findings of liability against them.[2] These appeals were consolidated

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[1] Petitioner, designated as "American Underwriters", did not appeal interlocutorily. The American Underwriters were, and are, acting separately because their portion of the hull claim was paid under a reservation of rights. A standstill agreement has been executed by the American Underwriters, Occidental and Hvide, reserving actions among those parties, if any, until the completion of appeals in this matter.

[2] American Underwriters did appear as Appellee in this appeal.

by the Fifth Circuit on July 17, 1986.

On September 16, 1986, Avondale, Hvide and other defendants filed Motions to Dismiss the consolidated appeals for lack of subject matter jurisdiction. These motions were denied by the Fifth Circuit on November 5, 1986, and the case was remanded to the District Court for reconsideration of its decision on liability in light of this Court's decision in *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 106 S.Ct. 2295, 90 L.Ed 2d 865 (1986) ("*East River*").

After receiving briefs and hearing argument on the issue, the District Court issued an opinion on remand on July 15, 1987 in which it held that *East River* was inapplicable to a contract to perform services. Avondale and Hvide appealed from this opinion, and all appeals were consolidated in the Court of Appeals.

In its decision, the Fifth Circuit correctly held that there was admiralty and maritime jurisdiction over this proceeding, and that pendant jurisdiction could be exercised over the contractual claims brought under New York law. However, although it agreed with the Trial Court that the OXY PRODUCER was delivered in a defectively mated condition which rendered the vessel unseaworthy, the Court deprived Occidental and its underwriters of all remedies under the Construction Contract and their remedies against Hvide in tort. The Court's "construction" of the Guarantee Deficiency Clause of the Construction Contract in effect converted a clause designed to provide an optional benefit *to Occidental* into a limitation of remedies which deprived it of the substantial value of its bargain. Furthermore, the Court allowed Hvide to assert a defense it had waived in the Trial Court, and, through its improper extension of the economic loss rule announced in *East River*, incorrectly dismissed plaintiffs' tort claims

for failure to state a claim. It is upon these issues that the American Underwriters petition this Court for certiorari.

ARGUMENT

A. The Guarantee Deficiency Clause of the Vessel Construction Contract Does Not Subsume Avondale's Express Warranty of Seaworthiness.

After construing the Construction Contract and finding that an express warranty of seaworthiness was incorporated into the contract from the vessel specifications, the Appellate Court held that the parties intended this warranty to be "subsumed" by the Guarantee Deficiency Clause. *Employers Insurance,* 866 F.2d at 775. As a result, it limited plaintiffs to the recovery of the cost of the repair or replacement of the interconnection system of the ITB. This holding is contrary to New York law, the law stipulated by the parties to govern their transaction.

The Guarantee Deficiency Clause, provides:

> "notwithstanding any approval of contract drawings, inspection or failure to reject by the Purchaser. . .pursuant to this Construction Contract, if at any time during the Guarantee Period there shall appear or be discovered any Guarantee Deficiency, such Guarantee Deficiency shall be made good, at the contractor's expense, to the requirements of the Vessel Plans and Specifications and this Construction Contract. (Construction Contract Article XVIII(a)).

A "Guarantee Deficiency" is defined as any weakness, failure or deterioration of workmanship or material, or the failure of any equipment, machinery or material to function

as prescribed in the Vessel Plans and Specifications. *Id.*, Article I(n). Under this provision, which on its face appears to contemplate only defects in vessel components, Avondale is obligated to repair a condition or replace any defective part which gives rise to a Guarantee Deficiency if the clause is invoked. *Id.*, Article XVIII(a). However, the clause cannot be read to subsume Avondale's warranty of seaworthiness.

In interpreting a contract, "that interpretation is favored which will make every part of the contract effective." *National Equipment Rental, Ltd. v. Reagin*, 338 F.2d 759 (2d Cir. 1964), *Bloor v. Falstaff Brewing Corp.*, 454 F.Supp. 258, 266 (S.D.N.Y. 1978), *aff'd*, 601 F.2d 609 (2d Cir. 1979), *Rentways, Inc. v. O'Neill Milk & Cream Co.*, 308 N.Y. 342, 347, 126 N.E. 2d 271, 273 (N.Y. 1955). When two seemingly conflicting contract provisions can reasonably be reconciled, a court is *required* to do so and to give both effect. This applies with equal force when one document incorporates the terms of another, as the Vessel Construction Contract did the warranty of seaworthiness here. *Proyecfin de Venezuela, S.A. v. Banco Industrial de Venezuela, S.A.*, 760 F.2d 390 (2nd Cir. 1985), *National Conversion Corp. v. Cedar Building Corp.*, 23 N.Y. 2d 621, 298 N.Y.S. 2d 499, 246 N.E. 2d 351 (N.Y. 1969), 3 *Corbin on Contracts* Section 547, at 172-3 (1960).

With these principles in mind, it becomes clear that the Guarantee Deficiency Clause is nothing more than a "guarantee" of workmanship and material; rather than excluding or limiting plaintiffs' remedies for breach of the contract and the warranty of seaworthiness, the provision imposes a *separate* and *additional* obligation on Avondale to repair or replace defective material or workmanship for one year after the delivery and acceptance of the vessel. As a guarantee, the provision does not provide plaintiffs' ex-

clusive remedy under the construction contract. Contrary to the Fifth Circuit's ruling, New York law does not interpret these clauses to subsume or extinguish the express warranties set forth in the contract. *Schulman Investment Company v. Olin Corp.*, 477 F.Supp. 623, 628 (S.D.N.Y. 1979), *Carrols Equities Corp. v. Villnave*, 57 A.D. 2d 1044, 395 N.Y.S. 2d 800 (4th Dept. 1977), *appeal den.*, 42 N.Y. 2d 810, 399 N.Y.S. 2d 1026, 369 N.E. 2d 775 (N.Y. 1977), *Town of Tonawanda v. Stapell, Mumm & Beals*, 240 A.D. 472, 270 N.Y.S. 377 (N.Y.A.D. 4 Dept. 1934), *aff'd*, 265 N.Y. 630, 193 N.E. 419 (N.Y. 1934), see also *Complaint of American Export Lines, Inc.*, 620 F. Supp. 490, 516 (S.D.N.Y. 1985). This interpretation is also prevalent in other jurisdictions. *See e.g., Baker-Crow Construction Company v. Hames Electric, Inc.*, 566 P.2d 153 (OK App., Div. 1, 1976). Thus, rather than limit Avondale's liability for breach of warranty, the clause gives Occidental the option of requiring Avondale to repair the defect. This conclusion is also compelled by the Uniform Commercial Code, upon which the Fifth Circuit relied in making its decision.

Although the code permits the seller to limit the purchaser's remedies to repair or replacement of nonconforming goods or parts, the limitation "is optional unless the remedy is *expressly agreed to be exclusive*, in which case it is the sole remedy". "Warranties, whether express or implied *shall be construed* as consistent with each other and *as cumulative ...*" N.Y. U.C.C. Sections 2-719(1)(b), 2-317 (McKinney 1964), *See e.g., Curtis v. Murphy Elevator Company*, 407 F. Supp. 940 (E.D. Tenn. 1976). These provisions create a presumption that clauses setting forth remedies are *cumulative* rather than exclusive. If the parties intend the term to describe the sole remedy under the contract, this intention must be clearly expressed. *Stream v. Sportscar Salon, Ltd.*, 91 Misc. 2d 99, 397 N.Y.S. 2d 677 (N.Y. City Civ. Ct. 1977). Nowhere in the Guarantee Deficiency

Clause, or in the Construction Contract generally, is it stated that repair or replacement of defective material or workmanship is the exclusive *remedy* under the contract.

The only provision of the Construction Contract which mentions exclusivity is paragraph (g) of Article XVIII. That paragraph provides:

> (g) THE WARRANTIES AND GUARANTEES SET FORTH IN ARTICLE VIII RELATING TO SPEED, FUEL CONSUMPTION, SPA CARRYING CAPACITY AND DEADWEIGHT TONNAGE, IN THIS ARTICLE XVIII, RELATING TO ANY GUARANTEE DEFICIENCY AND IN ARTICLE XXXVIII RELATING TO DESIGN RESPONSIBILITY FOR THE BARGE, ARE EXCLUSIVE AND ARE IN LIEU OF ALL IMPLIED WARRANTIES (INCLUDING BUT NOT LIMITED TO ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE AND WORKMANLIKE SERVICES).

This provision, being a disclaimer or limitation of warranties, must be strictly construed. *Computerized Radiological Services, Inc. v. Syntex Corp.*, 595 F.Supp. 1495 (E.D.N.Y. 1984), *aff'd in part, rev'd in part on other grounds*, 786 F.2d 82 (2nd Cir. 1986), *Arnold v. New City Condominiums Corp.*, 78 A.D. 2d 882, 884, 433 N.Y.S. 2d 196 (N.Y.A.D. 2 Dept., 1980), *appeal dismissed*, 53 N.Y. 2d 823, 439 N.Y.S. 2d 922, 422 N.E. 2d 582 (N.Y. 1981) *appeal dismissed*, 53 N.Y. 2d 604, 439 N.Y.S. 2d 1028, 422 N.E.2d 583 (N.Y. 1981).

> Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each

> other, but...negation or limitation is inoperative to the extent that such construction is unreasonable. N.Y. U.C.C. Section 2-316(1) (McKinney 1964)

As the Trial Court correctly found, Article XVIII(g) at most disclaimed all implied warranties, and does not, through its language of exclusivity, extinguish the express warranty of seaworthiness. An attempt both to warrant and to refuse to warrant goods creates an ambiguity which can only be resolved by making one term yield to the other. Section 2-316 of the Uniform Commercial Code provides that warranty language prevails over the disclaimer, if the two cannot be reasonably reconciled. *Wilson Trading Corp. v. David Ferguson, Ltd.*, 23 N.Y. 2d 398, 405, 297 N.Y.S. 2d 108, 113, 244 N.E. 2d. 685, 689 (N.Y. 1968).

Construing a beneficial clause, such as the Guarantee, to extinguish the express warranty of seaworthiness is patently unreasonable when that clause, on its face, deals not with the overall functioning of the vessel, but instead with defects in its individual components. Nothing is more fundamental to a shipbuilding contract than that the vessel constructed will float. Avondale expressly warranted that the OXY PRODUCER would be seaworthy and suitable for its intended purpose, yet it sank on its second voyage. Why would the parties bother to set forth an express warranty of seaworthiness in the Contract if it were subsumed in the Guarantee Deficiency Clause? Furthemore, the word "exclusive", as used in Article XVIII(g) of the contract, is clearly used only to confine the list of warranties that were given in addition to the warranty of seaworthiness. It in no way purports to limit the remedy for the breach of any warranty to the cost of repair or replacement of the condition giving rise to the breach.

Occidential did not build the OXY PRODUCER as a novel experiment to push the limits of naval architecture as suggested by the Fifth Circuit. *Employers Insurance*, 866 F.2d at 779. The record is clear that Occidental accepted Hvide's design of the catug ITB as a *proven*, economical system to deliver its products to market. There is absolutely no evidence that Occidental contracted to assume the risk that the OXY PRODUCER would sink like a rock due to defects in its construction.

Contrary to New York law, the Court has converted an optional benefit under the Contract running in favor of Occidental into a limitation of Occidental's warranty rights. It has rewritten the contract negotiated by the parties through the guise of "interpretation." This it cannot do. *Laba v. Carey*, 29 N.Y. 2d 302, 327 N.Y.S. 2d 613, 618, 277 N.E. 2d 641 (1971), *reh. den.*, 30 N.Y. 2d 694, 332 N.Y.S. 2d 1025, 283 N.E.2d 432 (N.Y. 1972), *Seifert, Hirshorn & Parkman, Inc. v. Insurance Company of North America*, 36 A.D. 2d 506, 321 N.Y.S. 2d 815, 816 (1st Dept. 1971). Certiorari should be granted on this issue, and the Appellate Court's redrafting of the Contract reversed.

B. The Repair or Replace Remedy Set Forth in the Guarantee Deficiency Clause Has Failed of Its Essential Purpose and Does Not Limit Recovery to the Cost of Repair or Replacement of Defective Material or Workmanship.

Even if the Guarantee Deficiency Clause could be construed as the exclusive remedy for loss of the vessel under the Construction Contract, that provision would not preclude plaintiffs from recovering damages. Not only does the repair or replacement remedy fail of its essential purpose, the provision the Court construed as a limitation of Occidental's remedies to the cost of repair of the defects

in the vessel is linked with the repair or replace remedy and also falls. A contrary construction impermissibly deprives Occidental of the substantial value of its bargain.

Section 2-719(2) of the UCC provides that "where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this Act." N.Y. U.C.C. Section 2-719(2) (McKinney 1964). This section applies whenever an exclusive remedy, which may have appeared fair and reasonable at the inception of the contract, operates to deprive a party of the substantial benefit of his bargain as a result of later circumstances. *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*, 95 A.D. 2d 5, 465 N.Y.S. 2d 606, 611 (A.D. 4 Dept. 1983).

Although repair or replacement remedies are deemed to fail most frequently in situations when the seller is unable to put the goods in warranted condition after repeated attempts to do so, the remedy also fails in situations when the goods were destroyed as the result of their defects. 1 White & Summers, *Uniform Commercial Code, Practitioners Edition* (3d Ed. 1988), Para. 12-10 at 602.

> The purpose of a repair-or-replace contracted remedy is to give the buyer what he bargained for, namely goods that measure up to the contract... This purpose is defeated if the goods are destroyed by their own flaws so that repair or replacement are totally unsatisfactory. For example, suppose the seller expressly warrants the quality of brake linings he has sold to the buyer; that the contract also contains a provision that if the brake linings prove defective the buyer's exclusive remedy is to have them repaired or replaced free of charge by the seller; (and) that as a result of the failure of the brake linings, the buyer's car is totally destroyed in a collision...

> Under these circumstances, the repair-or replace remedy fails of its essential purpose, because it makes no sense to repair or replace the brake linings of a demolished car. Hawkland, *UCC Series* Section 2-719:03.

It appears that this approach is followed in every jurisdiction which has addressed the issue, and, when the product is destroyed due to latent flaws, the repair-or-replace remedy has been held to have failed of its essential purpose. The purchaser is then permitted to resort to his other remedies under the Code. *Rudd Const. Equip. Co., Inc. v. Clark Equip. Co.*, 735 F.2d 974 (6th Cir. 1984); *Comind, Companhia de Seguros v. Sikorsky Aircraft*, 116 F.R.D. 397 (D. Conn. 1987); *Russo v. Hilltop Lincoln-Mercury, Inc.*, 479 S.W. 2d 211 (Mo. App. 1972); *Ford Motor Co. v. Reid*, 250 Ark. 176, 465 S.W. 2d 80 (Ark. 1971); *State Farm Mut. Auto Ins. Co. v. Anderson-Weber, Inc.*, 110 N.W. 2d 449 (Iowa 1961). This result is consistent with New York law. *Cayuga*, 465 N.Y.S. 2d at 611 (the total inability to repair can also deprive the buyer of the benefit of his purchase).

Because the OXY PRODUCER sank in the Atlantic Ocean beyond salvage and repair, the repair and replace remedy has failed of its essential purpose. Occidential bargained for a seaworthy vessel to transport its products, a bargain the repair or replacement remedy can no longer achieve.

The Guarantee Deficiency Clause also provides that:

> The Contractor shall not be liable to the Purchaser for any damages to the vessel or its equipment or cargo or other property of such Purchaser or for consequential damages of Purchaser *arising out of any such Guarantee Deficiency*, except that in the event of any Guarantee Deficien-

> cy in any item of machinery or equipment furnished by the Contractor, the Contractor shall be liable not only for the cost of correcting or repairing such Guarantee Deficiency, but also shall be liable for the cost of correcting or repairing the damage to the item of machinery or equipment on the vessel caused by such Guarantee Deficiency. Construction Contract, Article XVIII(a),

Relying on *American Electric Power Company, Inc. v. Westinghouse Electric Corporation*, 418 F. Supp. 435 (S.D.N.Y. 1976), the Court held that this portion of the Guarantee Deficiency Clause would survive the failure of the repair or replace warranty stated earlier in the clause. This conclusion is belied by the Courts *own authority.*

American Electric involved a defective generator sold to the utility by Westinghouse. The contract of sale contained an exclusive repair or replace remedy and *a separate provision* limiting consequential damages. Although repeated attempts to bring the generator up to warranted capacity had been made, the generator failed to operate properly, and Westinghouse refused to provide a replacement. The court held that *because the limitation* provision of the contract *was separate and independent* from the repair and replace warranty, and *because the utility was left with an adequate remedy* under the contract, through recovery of the purchase price of the generator, the limitation could stand in spite of the failure of the repair or replace warranty. *American Electric*, 418 F. Supp. at 458-9. Contrary to the ruling of the Fifth Circuit, the conditions upon which this holding was based are not present here. The limitation provision does not survive the failure of the repair or replace remedy.

Unlike the situation in *American Electric*, the limitation in this case *is a part of the very provision that has*

failed, the Guarantee Deficiency Clause. By its very terms, the limitation only applies to the consequences caused by a Guarantee Deficiency, and is intimately tied to the repair or replace warranty. Only when the limitation is separate, and can stand or fall independently, does it survive the failure of the exclusive remedy. *American Electric,* 418 F. Supp. at 458; *County Asphalt, Inc. v. Lewis Welding & Engineering Corp.*, 323 F. Supp. 1300, 1309 (S.D.N.Y. 1970), *aff'd* 444 F.2d 372 (2d Cir. 1971), *cert. den.*, 404 U.S. 939, 92 S.Ct. 172, 30 L.Ed. 2d 252 (1971). Because the limitation is a part of the Guarantee Deficiency Clause, and is linked to and dependant on the repair or replacement remedy it provides, any failure of the repair or replace remedy also destroys the limitation.

Furthermore, although parties to a contract are given broad latitude to fashion their own remedies for breach of contract, the very essence of a sales contract is that at least minimum adequate remedies be available for its breach. If parties intend to conclude a contract for sale, they must accept the legal consequence that there be at least a fair quantum of remedy. *Wilson Trading Corp. v. David Ferguson, Ltd.*, 23 N.Y. 2d 398, 297 N.Y.S. 2d 108, 244 N.Ed. 2d 685 (N.Y. 1968). "Where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions" of the Code. *American Electric,* 418 F. Supp. at 458, quoting *Official Comment* 1 to §2-719 of the UCC.

In *American Electric* the contract provided for a *damage recovery* distinct from the warranty to repair or replace. If the generator could not be repaired by Westinghouse, American Electric could recover the *full purchase price* of the generator as damages, plus any addi-

tional direct damages in excess of this amount, since the contract excluded only consequential loss. The Court considered this factor most important in making its decision. *American Electric,* 418 F. Supp. at 458-9.

Here, however, the Appellate Court appears to read the provision as limiting plaintiffs to the recovery of only the *cost* of repairs even if the repair or replace remedy has failed. Thus, under this interpretation of the contract, as stated by the Trial Court, if it could be shown that the sinking resulted from the failure of a $1.00 part, Avondale would staisfy its obligation by tendering to Occidental $1.00, while leaving Occidental to absorb a loss, for the vessel alone, in excess of $30 million. It bears repeating that Occidental bargained only for an economical transportation system to carry its products to the Soviet Union. To accomplish this end it chose a proven design that had been utilized by Hvide successfully for years. To hold that it limited its remedy to the cost of repair of any defects, and assumed the risk that the vessel would not float, is, as characterized by the District Court, an absurd result. Such a conclusion deprives Occidental of the substantial value of its bargain, the purchase of an economical, but reliable vessel, and cannot stand.

C. The Rule of *East River* Should Not Be Extended To Bar Maritime Tort Claims Against Hvide, a Party Which Contracted To Provide Professional Services in Connection with the Design and Construction of the Vessel.

Prior to this Court's ruling in *East River,* it was feared that the law of contract "would drown in a sea of tort." See G. Gilmore, *The Death of Contract* 87-95(1974), *East River,* 106 S. Ct. at 2300, However, since that decision was handed down, and the floodgates opened, the sea of tort has been rapidly draining away. Tort claims have been

barred, even where maritime jurisdiction has been found, against the supplier of component parts of a vessel, with whom the vessel owner was not in privity of contract, *See Shipco 2295, Inc. v. Avondale Shipyards, Inc.*, 825 F.2d 925 (5th Cir. 1987), *cert. den.*, —U.S.—, 108 S.Ct. 1472, 99 L.Ed. 2d 701 (1988), and now against the furnisher of supervisory services in connection with the construction of a vessel. This Court should now step in to regulate the flow from the floodgates it has opened, by defining, as it did with tort claims, the extent to which contract law and tort law will apply.

The issue raised in this case is whether the economic loss rule applies to contracts for professional services, rendered in connection with the manufacture of a product, by a party other than the manufacturer. As noted by the Appellate Court, this is an issue of first impression.[3]

The cause of action for negligent performance of professional services has been described as follows:

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[3] The Appellate Court cited both *Flintkote Co. v. Dravo Corp.*, 678 F.2d 942 (11th Cir. 1982) and *PPG Industries, Inc. v. Sundstrand Crop.*, 681 F. Supp. 287 (W.D. Pa. 1988) as extending the economic loss rule to contracts for professional services. However, it appears that in both cases the party performing the services was also engaged in the manufacture of the product. In *Flintkote*, Dravo actually performed much of the construction of the cargo unloader, and provided supervisory and inspection services only with respect to its subcontractors. While the situation in *PPG Industries* is far from clear, PPG did issue purchase orders *for the manufacture* and supply of the product to Sundstrand, which ultimately filled the order. *PPG Industries*, 681 F. Supp. at 288. To the extent these cases involve supervisory or professional services performed by the manufacturer, they go no farther than this Court's holding in *East River*, where the manufacturer supervised the installation of its vessel propulsion system.

> Where a person contracts to do certain work he is charged with the common law duty of exercising reasonable care and skill in the performance of the work required to be done by the contract. It is the breach of the duty imposed by law, and not of the contract obligation, whch constitutes the tort. *Consolidated Edison Company of New York, Inc. v. Westinghouse Electric Corporation,* 567 F. Supp. 358, 364 (S.D.N.Y. 1983).

Unlike a contract for the sale of goods, contracts for services are not governed by the UCC. While the implied warranties provided by the UCC provide an adequate replacement for the imposition of a duty in tort when the defective product injures itself, no such protection from economic loss exists for the purchaser of services, absent a duty of proper performance. *Employers Insurance,* 866 F.2d at 764. Because the work of professionals often cannot be precisely defined by contract, special non-contractual duties enforced by tort law make up for the lack of sophistication of the parties who seek them. *PPG Industries,* 681 F. Supp. at 290.

Simply because professional services are sought in a commercial context does not mean that the parties are sufficiently knowledgeable concerning the results they seek to obtain from those services to arrive at a fairly bargained allocation of risks. Indeed, the very fact that it is necessary to enter into a contract with a third party for such services demonstrates a certain lack of sophistication with respect to the task to be performed.

While Occidental is sophisticated in world chemical markets, trading, in this case, with the Soviet Union, it is not a shipbuilder. Its very lack of sophistication with shipbuilding in general, and the catug ITB design in particular, led it to Hvide, an entity with particular expertise concern-

ing the design, construction and operation of catugs. Occidential depended on Hvide to oversee the process of development and construction of the vessels it needed to trade with the Soviet Union. Instead of correctly performing this role, Hvide, along with Avondale, permitted the OXY PRODUCER to be delivered with catastrophic defects.

The extension of the *East River* rationale in this case goes too far. It is easy, in a commercial context, to be caught up in the talismanic language of "benefit of the bargain" and "equality of bargaining power" found in contract law, and fall prey to its illusory magic. When, as here, the Court blindly extends contract law into a area that still requires the protection of duties imposed by the law of tort, real harm can be done. It is up to this Court to break the spell. Occidental should not be forced to absorb a loss in excess of $30 million, resulting from Hvide's negligence, under the illusion that this result merely fulfills the expectations of the parties.

D. *East River* Cannot Be the Basis for Assertion in the Court of Appeals of a Defense Waived by Hvide in the Trial Court.

Although the debate concerning the economic loss rule was raging prior to *East River,* at no time throughout the course of the trial did Hvide assert the defense that plaintiffs' Complaint failed to state a claim, whether based on the economic loss rule, or otherwise. Nevertheless, because *East River* was the law in effect at the time of the decision on appeal, the Fifth Circuit, relying on *Bradley v. School Bd. of City of Richmond, VA.*, 416 U.S. 696, 94 S.Ct. 2006, 40 L.Ed. 2d 476 (1974), and *Nations v. Sun Oil Co.*, 695 F.2d 933 (5th Cir. 1983), *cert. denied* 464 U.S. 893, 104 S.Ct. 239, 78 L.Ed. 2d 229 (1983), permitted Hvide to

assert this defense for the first time on appeal over the objection of the American Underwriters. *Employers Insurance,* 866 F.2d at 761 n. 11. By sustaining Hvide's contention, the Fifth Circuit incorrectly permitted Hvide to assert a defense it had waived in the Trial Court, and to escape a Judgment of liability for its negligence in supervising the construction of the OXY PRODUCER. This Judgment may have provided Occidental a basis for the recovery of a sum in excess of $30 million for the loss of the vessel. This action marks such a great departure from the accepted and usual course of judicial proceedings embodied in Rule 12(h)(2) as to warrant the exercise of this Court's power of supervision.

On appeal, Hvide contended that the Trial Court's conclusion that it was negligent in its supervision of the mating of the tug and barge units of the ITB was erroneous as a matter of law. It argued that, under the rule of *East River,* which was decided by this Court *after* the conclusion of the trial on the merits, a Complaint only alleging damage to a defective product failed to state a claim upon which relief may be granted. Because its conduct caused no injury to persons or property other than the Oxy Producer, Hvide contended that it fell within this rule, and, as a result, plaintiffs could assert no tort claim against it. Whether or not the rule of *East River* extends to supervisory services of the type performed by Hvide in connection with the construction of the OXY PRODUCER ITB, Hvide could not raise that defense in the Court of Appeals.

Rule 12(h)(2) of the Federal Rules of Civil Procedure permits the defense of failure to state a claim to be raised at any time *before* a disposition on the merits, but not *after. Snead v. Department of Social Services of New York,* 409 F.Supp. 995, 1000 (S.D. N.Y. 1975) *see also Black, Sivalls & Bryson, Inc. v. Shondell, 174 F.2d 587, 590-1 (8th Cir.*

1949). The defense may not be asserted for the first time on appeal. *Madore v. Ingram Tank Ships, Inc.*, 732 F.2d 475 (5th Cir. 1984). *See also Brule v. Southworth*, 611 F.2d 406, 409 (1st Cir. 1979), *Simpson v. Alaska State Comm. For Human Rights*, 608 F.2d 1171, 1174 (9th Cir. 1979).

Although Hvide cast its argument in the form of an appeal from an erroneous ruling of law, it merely attacked the legal sufficiency of the Complaint. Therefore, its contention should have been deemed to raise the defense of failure to state a claim, and should have been made no later than at the trial on the merits. *Weaver v. Bowers*, 657 F.2d 1356, 1359 (3d Cir. 1981), *cert. den.*, 455 U.S. 942, 102 S.Ct. 1435, 71 L.Ed.2d 653 (1982). The Fifth Circuit recognized that the thrust of Hvide's contention was that the Complaint failed to state a claim upon which relief could be granted, *Employers Insurance*, 866 F.2d at 759, but, nonetheless, permitted Hvide to raise that issue on appeal.

Neither of the decisions relied on by the Appellate Court support its action. *Bradley* involved an award of attorneys fees to a plaintiff in a school desegregation case. Although no statute authorized the award, the Trial Court in that case granted attorneys fees on equitable grounds. While the issue was pending in the Court of Appeals, Congress passed the Education Amendments Act of 1972. The statute expressly authorized the award of attorneys fees. The Court of Appeals refused to sustain the award and held that the statute could not be applied retroactively. The decision of the Court of Appeals was reversed by this Court and the statute applied, because the issue of attorney's fees *had been presented in the Trial Court* and was before the Court of Appeals at the time of the statute's enactment:

> The question, properly viewed, then, is not simply one relating to the propriety of retroactive ap-

> plication of (the statute) to services rendered prior to its enactment, but rather, one relating to the applicability of (the statute) to a situation *where the propriety of a fee award was pending resolution on appeal when the statute became law.* 94 S.Ct. at 2015.

The Fifth Circuit's own decision in *Nations* is of the same effect. There, an intervening decision extended the statutory employer defense arising under a workmans compensation statute. Although the defense had not been addressed initially in the defendant's appellate brief or in its Motion for Judgment Notwithstanding the Verdict, it had been timely raised in the Court below.

Both *Bradley* and *Nations* turned, in part, upon the fact that the intervening change in the law addressed issues which *already had been raised* in the Trial Court and were pending on appeal. Thus, rather than compel the rejection of plaintiffs' waiver argument, these decisions, if anything, *support* plaintiffs' position.[4]

Although Hvide's answer contained the general defense that the Complaint failed to state a claim upon which relief could be granted, this general statement was

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[4] This result is consistent with other cases applying *East River* on appeal to dismiss an action for failure to state a claim, *Pott Industries, Inc. v. Ingram River Equipment, Inc.*, 477 U.S. 902, 106 S.Ct. 3269, 91 L.Ed. 2d 560 (1986), *Shipco 2295, Inc. v. Avondale Shipyards, Inc.*, 825 F.2d 925 (5th Cir. 1987). In both of these cases, as in *East River* itself, the defense of failure to state a claim was raised and litigated at or before the trial on the merits. Therefore, the defense was timely raised and before the Court of Appeals, See *Ingram River Equipment, Inc. v. Pott Industries, Inc.*, 573 F. Supp. 896, 901 (E.D. Mo. 1983), *Shipco 2295, Inc. v. Avondale Shipyards, Inc.*, 631 F. Supp. 1123, 1136 (E.D. La. 1986, *Aff'd* 825 F.2d 925 (5th Cir. 1987), *cert, den.*, —U.S.—, 108 S.Ct. 1472, 99 L.Ed. 2d 701 (1988). This is not the situation here.

insufficient to permit Hvide to press the issue for the first time in an Appellate Court. The statement of a defense in general terms suffices only when a single, definite and certain question is thereby presented. *C. Albert Sauter Co. v. Richard S. Sauter Co.,* 368 F. Supp. 501 (E.D. Pa. 1973). When the failure of the allegations to state a claim is not apparent from the face of the Complaint, a failure by a party to particularize the defects upon which it relies constitutes a waiver of the right to rely on the defense. *Smead v. Carpenter,* 274 F.2d 414 (9th Cir. 1960), *Sauter,* supra. A ground raised but not pressed or clearly presented to the district court is abandoned. *Heiar v. Crawford County, Wisconsin,* 746 F.2d. 1190 (7th Cir. 1984), *cert. den.,* 472 U.S. 1027, 105 S.Ct. 3500, 87 L.Ed. 2d 631 (1985), *Nathan Rodgers Construction & Realty Corp. v. City of Saraland,* 676 F.2d 162 (5th Cir. 1982). Hvide's perfunctory statement in its answer was inadequate to put plaintiffs on notice of its defense. This is particularly true because, at the time of trial, the economic loss rule adopted by this Court was not recognized in the maritime law of the Fifth Circuit. *See, Jig III, Corp. v. Puritan Marine Insurance Underwriters Corp.,* 519 F.2d 171 (5th Cir. 1975), *reh. den.,* 522 F.2d 1280 (5th Cir. 1975), *cert. den.,* 424 U.S. 954, 96 S.Ct. 1429, 47 L.Ed. 2d 360 (1976).

East River defined the requirements for a legally sufficient claim in maritime tort, and, as such, concerned the defense of failure to state a claim. Unlike a defense asserting a lack of subject matter jurisdiction over a claim, this defense can be waived if not timely asserted. Had Hvide pressed the defense of failure to state a claim in the Trial Court, as was done by the defendants in *Pott Industries* and *Shipco,* the latter of which also arose in the Fifth Circuit, there would be no question that the issue would have been before the Appellate Court and governed by *East River,* even though *East River* was decided after the com-

pletion of the liability portion of the trial. However, because the defense of failure to state a claim cannot be raised for the first time on appeal, and because Hvide failed to assert the defense at trial, any benefit afforded Hvide by this defense has been waived. Fed. R. Civ. P. 12 (h)(2). The Fifth Circuit's departure from Rule 12(h)(2) should not be permitted to stand.

CONCLUSION

In the aftermath of the sinking of the OXY PRODUCER, Occidental was left with its remedies under contract and the law of tort. It had contracted with Hvide, an expert in the design, construction and operation of catug ITB's, and with Avondale, an expert shipbuilder, both of whom warranted the seaworthiness of the ITB and purported to perform their roles with due care. However, even though the Court of Appeals found, as did the Trial Court, that Hvide and Avondale had breached their respective contracts and were negligent in their mating of the vessel, in the aftermath of its decision Occidental was left with nothing. The Fifth Circuit's tortured interpretation of the vessel construction contract deprived Occidental of the benefit of its bargain, a result directly contrary to the law of New York, which was chosen to govern the contract, and the expectation interests recognized by this Court in *East River*. The Court also extended the economic loss rule adopted in *East River* from the maintenance of product quality, an area where the need for the tort duties extinguished by the rule are weak, to the provision of professional services by a party other than the manufacturer, an area where the need for imposing a tort duty is strong. Finally, the Court incorrectly permitted the assertion of a defense which was waived in the Trial Court, resulting in a departure from the accepted course of judicial proceedings.

For the foregoing reasons, the Petition for Certiorari of the American Underwriters should be granted and the decision of the Court of Appeals reversed.

Respectfully submitted,

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